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Message Text

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ACTION ARA-14

INFO OCT-01 ISO-00 AID-05 CIAE-00 COME-00 EB-08 FRB-01
INR-10 NSAE-00 ICA-20 TRSE-00 XMB-04 OPIC-06
SP-02 LAB-04 SIL-01 OMB-01 DODE-00 PM-05 H-02
L-03 NSC-05 PA-02 SS-15 IO-14 CEA-01 /124 W
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FM AMEMBASSY BUENOS AIRES
TO SECSTATE WASHDC 5704

UNCLAS SECTION 1 OF 2 BUENOS AIRES 3698

E.O. 11652 N/A
TAGS EFIN, ECON, AR
SUBJECT ARGENTINA: NEW STABILIZATION MEASURES ANNOUNCED

REF: BUENOS AIRES 3586

1. SUMMARY: IN HIS USUAL PROFESSIORIAL MANNER, MINISTER OF ECONOMY MARTINEZ DE HOZ ADDRESSED THE NATION MAY 11 TO ANNOUCE NEW MEASURES TO COMBAT INFLATION AND TO REVIVE PRODUCTIVE INVESTMENT. HE ASKED FOR THE COOPERATION OF THE WHOLE POPULATION IN ELIMINATING THE HABIT ACQUIRED FROM THIRTY YEARS OF BAD EXPERIENCES OF RAISING PRICES MORE THAN JUSTIFIED BY COSTS. HE REVIEWED THE ACCOMPLISHMENTS OF THE ECONOMIC TEAM IN CURBING THE PUBLIC SECTOS PREDOMINANT ROLE IN THE ECONOMY AND IN REDUCING ITS CONTRIBUTION TO INFLATION -- EG THE REDUCTION OF THE BUDGET DEFICIT BY LOWERING PUBLIC EXPENDITURES AND RAISING TAXES; THE TRANSFER OF FIRMS AND SHARES BACK TO THE PRIVATE SECTOR: AND THE REORGANIZATION OF STATE ENTERPRISES TO INCREASE PRODUCTIVITY. SPECIFIC NEW MEASURES ANNOUNCED INCLUDED CHANGES IN PROCEDURES FOR ADJUSTING RATES OF PUBLIC SERVICES; REPLACEMENT
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OF THE "MINI DEVALUATIOIN" EXCHANGE RATE SYSTEM BY A FREE MARKET EXCHANGE RATE BASED ON THE SUPPLY AND DEMAND FOR CURRENCY; REINSTITUTION OF A SYSTEM OF MANDATORY DEPOSITS IN PESOS FOR THOSE OBTAINING FOREIGN CREDITS; AND MORE FAVORABLE FINANCING FOR INVESTMENTS IN AGRICULTURE AND INDUSTRY. THE IMMEDIATE IMPACT OF THE MEASURES ON THE EXCHANGE

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RATE WAS FOR THE DOLLAR TO FALL A COUPLE OF POINTS.
BANKING SOURCES DO NOT BELIEVE THAT THE GOVERNMENT
WILL PERMIT THE EXCHANGE RATE TO FALL SUBSTANTIALLY
BECAUSE OF THE ADVERSE IMPACT ON EXPORTS.
HOWEVER, UNLESS THE GOVERNMENT IS TO REVERT TO
ITS PREVIOUS PRACTICE OF PUSHING UP THE PESO PRICE
OF THE DOLLAR, IT SEEMS LIKELY THAT THE PESO/DOLLAR
EXCAHNGE RATE WILL REMAIN STATIONARY FOR A WHILE,
GIVEN THE CURRENT AND ANTICIPATED SUBSTANTIAL
BALANCE OF TRADE SURPLUS. IN THE CONTEXT OF THE
DOMESTIC INFLATIONARY ENVIRONMENT, EXPORTS WILL
PROBABLY THEREFORE BE HURT AND IMPORTS ENCOURAGED.
THE ADVERSE IMPACT ON ECONOMIC ACTIVITY WOULD
PRESUMABLY BE COUNTERACTED BY THE FINANCIAL MEASURES
TO STIMULATE INVESTMENT. END SUMMARY.

2. THE MINISTRY OF ECONOMY ANNOUNCED FOLLOWING
SPECIFIC MEASURES:
A. ADJUSTMENT OF PUBLIC UTILITY RATES: THE
GOVERNMENT WILL NOT SUPPORT INEFFICIENCY IN THE
STATE ENTERPRISES BY ALLOWING THEM TO PASS ON
UNWARRANTED COSTS TO CONSUMERS VIA HIGY UTILITY
RATES. HENCEFORTH, RATE ADJUSTMENTS WILL BE MADE
DIFFERENTIALLY IN ACCORDANCE WITH THE PARTICUALR
SITUATION OF EACH STATE ENTERPRISE AND THE CURRENT MINIMUM
5 PERCENT ADJUSTMENT WULD BE ELIMINATED.
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B. EXCHANGE RATE POLICY: THE GOVERNMENT WILL
NO LONGER ADJUST THE EXCHANGE RATES BASED ON THE
EVOLUTION OF PRICE INDICES. THE MINISTER CITED
ARGENTINA PARTICULARLY FAVORABLE BALANCE OF
PAYMENT SITUATION AND HIGH LEVEL OF RESERVES,
WHICH AT THE SAME TIME, HAD PROMOTED THE EXPANSION
OF THE DOMESTICS MONEY SUPPLY MORE RAPIDLY THAN
DESIRED. THE EXTERNAL SECTORS IMPACT ON THE
MONEY SUPPLY HAD TO SOME EXTENT COUNTERACTED THE
PROGRESS ACHIEVED IN REDUCING THE BUDGET DEFICIT.
THE GOVERNMENT, THEREFORE, HAS DECIDED TO PERMIT
THE EXCHANGE RATE TO BE DETERMINED BY SUPPLY AND
DEMAND AND WILL ONLY INTERVENE IN THE EXCHANGE
MARKET TO AVOID SHARP FLUCTUATIONS. ALSO,
OBLIGATORY DEPOSITS IN LOCAL CURRENCY WILL BE
REQUIRED FOR FOREIGN LOANS, THUS EQUALIZING THE
INTERNAL AND EXTERNAL COSTS OF MONEY. REPORTEDLY,
THE DEPOSIT REQUIREMENT INITIALLY WILL BE 20
PERCENT FOR FINANCIAL LOANS AND 10 PERCENT FOR
TRADE FINANCING. TO THE EXTENT THAT THESE TWO
MEASURES REDUCE THE EXPANSIONOF THE MONEY SUPPLY,
THIS WILL PERMIT THE CENTRAL BANK TO REDUCE THE

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RESERVE REQUIREMT (CURRENTLY 43 PERCENT) AND THUS
THE COMPENSATION NECESSARY FROM THE MONETARY
REGUALTION ACCOUNT FOR TIME DEPOSITS (THE COMPEN
SATION HAS BEEN A MAJOR SOURCE OF MONETARY
EXPANSION).
C. FINANCIAL POLICY: THE GOVERNMENT HAS
DEVELOPED PRIME RATE INDICATORS FOR DIFFERENT
TERMS BASED ON OBSERVED INTEREST RATES PAID TO
DEPOSITORS. THESE PRIME RATES WILL BE USED FOR A
NEW GOVERNMENT BOND WITH A FLOATING INTEREST RATE,
AS WELL AS FOR LOANS AND DEPOSITS IN THE
FINANCIAL COMMUNITY. IT IS HOPED THAT THE FLOATING
INTERESTWILL LEAD TO LONGER MATURITIES AND
AVOID THE HIGH COSTS RESULTING FROM THE FEVERISH
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INTEREST RATES ON SHORT TERM LOANS EXPERIENCED
RECENTLY. BOTH THE BANCO DE LA NACION AND BANADE
WILL USE FLOATING EXCHANGE RATES AND EXTEND THE

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ACTION ARA-14

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UNCLAS SECTION 2 OF 2 BUENOS AIRES 3698

TERM OF CREDITS FOR INVESTMENTS IN AGRICULTURE AND
INDUSTRY.
D. TARIFF POLICY: A STUDY ON THE EFFECTIVE
PROTECTION OF THE CURRENT TARIFF SYSTEM WILL BE
MADE PUBLIC. A COMMITTEE HAS BEEN ESTABLISHED TO
DEVELOP A NEW TARIFF SCHEDULE. THE GOVERNMENT WILL

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NOT HESITATE TO USE THE TARIFF INSTRUMENT TO COMBAT
UNWARRANTED INCREASES IN PRICES.
E. OTHER MEASURES: THE MINISTER ANNOUNCED A
SERIES OF OTHER MEASURESINCLUDING: A GOVERNMENT
STUDY OF WAYS TO REDUCE THE COSTS OF INDUSTRIAL
RAW MATERIALS: AN ANTI DUMPING LAW; TEMPORARY
IMPORT WITHOUT DUTY OF RAW MATERIALS AND INTERMEDIATE
GOOD FOR USE IN PRODUCTS TO BE EXPORTED; THE
EXPEDITIOUS HANDLING OF REQUESTS FOR IMPORTS OF
MACHINERY AND EQUIPMENT NOT PRODUCED BY LOCAL
INDUSTRY: REORGANIZATION OF THE AUTOMOTIVE
INDUSTRY; AND REPLACEMENT OF AN ANTI TRUST LAW BY
ANOTHER ONE WHICH WILL PROMOTE COMPETITION AND
THUS HELP TRANSFORM THE CURRENTLY ARCHAIC
ARGENTINE MARKETING STRUCTURE. NO DETAILS WERE
GIVEN.

3. COMMENT: THE INITIAL REACTION FROM THE FINANCIAL
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COMMUNITY HAS BEEN GUARDED.SOURCES INDICATE THAT
IT IS TOO EARLY TO PREDICT THE FULL IMPACT OF THE
MEASURES ON FINANCIAL AND ECONOMIC ACTIVITY. THE
IMMEDIATE IMPACT OF THE MEASURES WAS TO FORCE THE
PESO/DOLLAR EXCHANGE RATE DOWN BY TWO PESOS. HOWEVER,
BANKING SOURCES DO NOT BELIEVE THAT THE GOVERNMENT
WILL PERMIT THE EXCHANGE RATE TO FALL SUBSTANTIALLY
BECAUSE OF THE ADVERSE IMPACT ON EXPORTS.
ALTHOUGH THE MANDATORY DEPOSIT REQUIREMENT MAY
CURB THE INFLOW OF CAPITAL, ARGENTINA STILL
ENJOYS A SUBSTANTIAL BALANCE OF TRADE WHICH,
OTHER THINGS BEING EQUAL, WOULD NORMALLY FORCE
DOWN THE EXCHANGE RATE UNTIL SUPPLY AND DEMAND
WERE EQUAL. UNLESS THE GOVERNMENT IS TO REVERT
TO ITS PREVIOUS PRACTICE OF PUSHING UP THE PESO
PRICE OF THE DOLLAR, IT SEEMS LIKELY THAT THE
PESO/DOLLAR EXCHANGE RATE WILL REMAIN STATIONARY
FOR A WHILE. IN THE CONTEXT OF THE CURRENT
HIGHLY INFLATIONARY ENVIRONMENT IN ARGENTINA, A
STATIONARY OR SLOW DEVALUATION OF THE PESO WILL
HURT EXPORTS AND ENCOURAGE IMPORTS -- TWIN
RESULTS WHICH WOULD HELP COMBAT INFLATION. THE
ADVERSE IMPACT OF TRADE ON ECONOMIC ACTIVITY WOULD
PRESUMABLY BE COUNTEARACTEDBY THE FINANCIAL
MEASURES TO STIMULATE INVESTMENT. AS FOR THE
AMERICAN EMPLOYEES AT THE EMBASSY IN BUENOS AIRES,
THEY WILL SEE THEIR LOCAL PURCHASING POWER
EVEN MORE DRASTICALLYDIMINISHED.
CASTRO

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